100 Years Standing Up for American Enterprise
U.S. CHAMBER OF COMMERCE

CARRIED INTEREST

CHAMBER POSITION

The Chamber supports the current law capital gains tax treatment of general partners' carried interests in partnerships.

- Carried interest represents the general partner's "sweat equity" contribution (e.g., expertise and management skills) to the partnership, in lieu of the cash contributions that are made by investor limited partners for their capital interests.
- Accordingly, the carried interest of the general partner should receive the same tax treatment as the capital interests of the limited partners, i.e., capital gains treatment.

The Chamber believes that capital gain treatment best reflects the economic realities of carried interest.

- General partners risk time, money, and effort in setting up and managing partnerships. They have a stake in whether the partnership succeeds or fails, similar to that of the investor limited partners who contribute cash.
- The source of carried interest is the earnings on the partnership's investments. Carried interest should receive the same tax treatment as other investment income, i.e., capital gains.

The Chamber believes changes to the tax treatment of carried interest would harm economic growth and job creation.

- Taxing carried interest as ordinary income would result in reduced credit flow, decreased economic activity, and less job growth.
- The long-term impact of ad-hoc tax increases, such as proposals to tax carried interest as ordinary income, will stifle innovation and only further depress an economy that is still trying to recover from the financial crisis in a period of record unemployment.

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CARRIED INTEREST 101

- **Basic Structure**
  - Most hedge funds are organized as partnerships, not corporations. The partnership structure avoids double taxation on earnings and provides more flexibility in setting up economic arrangements among the partners.
  - Hedge fund partnerships are limited partnerships: they have a small number of general partners who manage the fund and a much greater number of investor limited partners. The limited partners are investors in the fund and have no voice in the fund's management.

- **Tax Treatment**
  - Profits
    - Limited partners receive a share of partnership profits based on the amount of capital they have invested in the partnership. These profits are taxed as capital gains.
    - The general partner may also contribute a limited amount of capital to the fund, in which case, he receives a share of partnership profits based on his capital investment, just like the limited partners.
  - Fee Structure: The general partner charges two annual fees for managing the hedge fund, commonly called the "2 and 20."
    - First, the general partner receives a percentage of fund assets, typically 2%. This 2% fee is a fixed management fee, is not dependent on fund performance, and is taxed as ordinary income.
    - Second, the general partner receives a share, typically 20%, of the fund's earnings once a designated profits benchmark has been met by the fund. This fee, the profits share, is carried interest and currently is taxed as capital gains.

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